

Employers in Rate Class 40

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Employment Security Department
WASHINGTON STATE

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Why we did this study

Over the course of the last two legislative sessions, the state Legislature directed the department to conduct a series of six studies to learn more about the unemployment-insurance system and to determine the effects of recent law changes.

This study was specifically mandated by Engrossed Substitute Senate Bill 6885.

The goal is to identify the characteristics of employers in the highest tax rate class (rate class 40) and determine the extent to which these employers are being subsidized by other employers in the unemployment-insurance system.

The complete report is available online at www.studies.go2ui.com.

For more information, contact the Office of Communication & Legislation at 360-902-9308.

What we found

Background: Employers' unemployment tax rates are calculated based on how much their employees collected in unemployment benefits during the previous four years and the balance in the unemployment trust fund.

Since 2005, tax rates have included three components. The *experience tax rate* is based on how much an employer is charged for the benefits its employees collect and determines the employer's rate class. The *social tax rate* covers the difference between experience taxes paid in and benefits paid out. The *solvency surcharge* is charged when there is not enough money in the trust fund to cover a certain number of months of benefits – it has not been charged to date.

Employers in the highest rate class (rate class 40) do not pay the full cost of benefits paid to their employees. This happens because their experience tax rate (5.4 percent) is always lower than is necessary to recoup the benefits charged to their accounts, and their social tax rate is sometimes lower than it would otherwise be due to a cap on the combined experience and social tax rates.

Study: To meet the goal of this study, the team identified how many and what types of employers were in rate class 40 in 2005. They specifically examined industry, location, size and business structure of those employers. They also looked at employer movement into and out of rate class 40, as well as the effects of the recession. Finally, they determined the costs associated with employers in rate class 40 that must be covered by other employers.

Findings: In 2005, 9 percent of all employers were assigned to rate class 40. This represents 13,410 employers. Of those, 19 percent were private household employers, 17 percent were in specialty trade construction and 6 percent were in fruit and vegetable farming. At the same time, the industries that had the largest percentage of employers within their industries in rate class 40 were fishing, heavy and civil engineering construction, and nonresidential building construction.

Geographic location did not have a notable effect on whether an employer was assigned to rate class 40, but business size did. Employers with fewer than five employees made up 78 percent of employers in rate class 40, compared to 67 percent of all employers in 2005.

Employers spent an average of three years in rate class 40. About one-third moved out of it between 2000 and 2005 because they went out of business. Of the employers that stayed in rate class 40 all six of those years, most were in construction; agriculture, forestry and hunting; and fishing; and 60 percent had fewer than five employees.

In 2005, employers in rate class 40 paid \$114 million less in taxes than they were charged for benefits. To keep the trust fund stable, employers in other rate classes must pay the difference.

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Introduction

The unemployment-insurance system is funded by employers' tax dollars. An employer's tax rate may change each year based on how much its employees collected in unemployment benefits during the previous four years and the balance in the unemployment trust fund.

The goal of this study is to identify the characteristics of employers in the highest tax rate class (rate class 40) and determine the extent to which these employers are being subsidized by other employers in the unemployment-insurance system. The study team was charged with identifying characteristics, such as industry, size, location, business structure, length of time in business and time spent in rate class 40; as well as the amount of tax these employers pay into the system and the cost of unemployment benefits paid to their employees.

For the purposes of this study, the term *all employers* refers to qualified employers¹ only. Non-qualified employers² are not included in study findings.

Background

How unemployment tax rates are calculated

In Washington State, each employer's unemployment tax rate is calculated based on the amount of benefits its workers collected and the balance in the unemployment trust fund. While this basis for tax calculations has remained constant, the way in which employers are assigned to a tax rate class and the components of the tax rate itself have changed over the last couple of years.

Prior to 2005, qualified employers were assigned to one of 20 rate classes, with 5 percent of employers assigned to each rate class based on their benefit ratios and taxable payrolls³. The benefit ratio is calculated by dividing the total cost of unemployment benefits charged to an employer⁴ in the past four fiscal years⁵ by its total taxable payroll for that same period.

In 2005, a 40-class tax rate system was introduced⁶. Rather than being divided up evenly across tax rates according to taxable payrolls, qualified employers are assigned to a rate class based solely on their benefit ratios. In addition, they pay a *social tax* and may pay a *solvency surcharge* depending on the balance in the unemployment trust fund. Employers' tax rates now include three components⁷:

- **Array Calculation Factor Rate** – Also known as the *experience tax rate*, this is the rate an employer earns based on the amount it is charged for the unemployment benefits its employees collect. It is determined by the rate class to which an employer is assigned, based on the

¹ Qualified employer: A business with employees over a specific time period that has submitted all reports, and paid all taxes, penalty, and interest charges as of September 30. RCW 50.29.010(6)

² Non-qualified employers: Businesses without employees over a specific time period or that have not submitted all reports, and paid all taxes, penalty and interest charges as of September 30. RCW 50.29.010(6) Non-qualified employers are assigned special tax rates. RCW 50.29.025(2)(c) & (d)

³ RCW 50.29.025(1)

⁴ RCW 50.29.021 specifies numerous situations in which employers are not "charged" for benefits paid to their workers.

⁵ July of one year through June of the following year.

⁶ RCW 50.29.025(2) & RCW 50.29.041

⁷ See Appendix A for details on unemployment tax rate classes and calculations.

employer's benefit ratio. For qualified employers, the experience tax rate ranges from 0 percent to 5.4 percent, but the actual tax rate does not necessarily equal the benefit ratio.

- **Graduated Social Cost Factor Rate** – Also known as the *social tax rate*, this is the rate that covers the “social cost” of the system, the difference between the amount of experience taxes and benefits paid for the past fiscal year. There are 12 social tax rates, which vary from year-to-year and by rate class.
- **Solvency Surcharge** – This charge is in effect only when the amount in the trust fund falls below the amount needed to pay benefits for a certain period of time. The solvency surcharge cannot exceed 0.2 percent, and all employers pay the same rate, regardless of rate class. Since being introduced in 2005, employers have not been charged the solvency surcharge.

State law limits the total of the experience and social tax rates to 6.5 percent for most qualified employers (the limit is 6 percent for employers in certain industries through 2007; then drops to 5.7 percent). If the combined tax rate for any qualified employer exceeds the limit, the social tax rate is reduced to the rate necessary to meet, but not exceed, the limit.

How employers in rate class 40 are subsidized

Two aspects of unemployment tax law contribute substantially to employers in rate class 40 being subsidized by employers in other rate classes:

- The experience tax rate for all employers in rate class 40 (5.4 percent) is *lower* than their benefit ratios, which are at least 5.75 percent. Therefore, some of the benefits paid to their workers are never recouped through the experience taxes they pay and must be covered by other employers.

Note: Employers in rate class 39 also have experience tax rates that are *lower* than their benefit ratios. Some employers in rate classes 2-9 and 37-38 and all employers in rate classes 10-36 have experience tax rates that are *higher* than their benefit ratios.

- The combined limit for experience and social tax rates of 6.5 percent means employers in rate class 40 may pay less in social taxes than they would otherwise be charged. The experience tax rate for rate class 40 is 5.4 percent. Because the combined limit is 6.5 percent for most industries, no employer in rate class 40 pays more than a 1.1 percent social tax rate. In some years, the rate they would otherwise pay is higher.

Example: In 2005, employers in rate class 40 would have had a 1.22 percent social tax rate. Most paid 1.1 percent because, when added to the 5.4 percent experience tax rate, the combined rate would have exceeded the limit at 6.62 percent. Employers in certain industries paid even less because their combined rate was capped at 6 percent. In 2006, the social tax rate was lower, so this was not an issue.

These two factors often result in employers in rate class 40 paying less in taxes than is necessary to pay for the benefits charged to them, which results in *ineffective charges*. *Ineffective charges* are the amount of benefit charges in a fiscal year for employers in a certain rate class that are not paid back in taxes the following calendar year by employers in that rate class. These charges are calculated by subtracting the amount of unemployment taxes (both experience and social) paid for a calendar year

by employers in a specific rate class from the amount of benefits charged to all employers in that rate class during the previous fiscal year⁸. Ineffective charges must be paid by other employers to keep the trust fund stable.

Rate class 40 has substantially more ineffective charges than any other rate class; most rate classes have none because they pay more in taxes than is required to cover their benefit charges. This means that in effect, employers in other rate classes subsidize employers in rate class 40.

Purpose of this study

In 2006, the state Legislature passed Engrossed Substitute Senate Bill 6885, which directed Employment Security to conduct four studies and report its findings by December 1, 2006. This is one of those four studies. It answers the questions:

- How many and what percentage of all employers are in rate class 40?
- Which industries are disproportionately represented in rate class 40?
- Where are employers in rate class 40 located?
- What is the size of employers in rate class 40?
- What is the business structure of these employers?
- How quickly or slowly did employers move into and out of rate class 40?
- How long have employers been in rate class 40?
- Did the recession impact employers moving to and staying at rate class 40?
- What are characteristics of employers in rate class 40 with benefit ratios over .054 for many years?
- What are the ineffective charges, benefit ratios, benefits paid, and benefit charges for these employers?

Findings

In 2005, 9 percent of all employers were assigned to rate class 40, which represents 13,410 out of 148,581 employers⁹.

Industry characteristics¹⁰

The following three industry sectors account for 42 percent of the employers in rate class 40, but less than 31 percent of all Washington employers:

- Private households¹¹ (19 percent of the employers in rate class 40; 22 percent of the employers in all rate classes). This industry includes COPES accounts¹².

⁸ July of one year through June of the following year. For example, ineffective charges for 2005 would be the taxes paid for 2005 minus the benefit charges from July 2003 through June 2004.

⁹ "All Employers" in this study refers to all "qualified employers": Businesses with employees over a specific time period that have submitted all reports, and paid all taxes, penalty and interest charges as of September 30. RCW 50.29.010(6)

¹⁰ See Appendix B for numbers and percentages for each industry sector.

¹¹ This includes employers who hire private caregivers (for the elderly, ill, and children), housekeepers, cooks, etc.

¹² Community Options Program Entry System: A program intended to provide caregiver assistance to people who might otherwise be at risk of nursing home placement, which is funded through the Washington State Department of Social and Health Services (DSHS). The individuals receiving care are considered the "employer" of the caregiver.

- Specialty trade contractors¹³ (17 percent of the employers in rate class 40; 6.5 percent of the employers in all rate classes).
- Fruit and vegetable farming (6 percent of the employers in rate class 40, 2 percent of the employers in all rate classes).

The industry sectors that had the largest percentage of employers within their industries in rate class 40 were:

- Fishing (71 percent of the employers in this industry are in rate class 40).
- Heavy and civil engineering construction¹⁴ (40 percent of the employers in this industry are in rate class 40).
- Nonresidential building construction¹⁵ (38 percent of the employers in this industry are in rate class 40).

Other business characteristics¹⁶

The geographic location of employers in rate class 40 in 2005 showed slight differences from those for all employers.

Close to one-third were located in rural counties and the other two-thirds in urban counties, with a slightly higher percentage of rate-class-40 employers in rural counties. Approximately one-third were located in eastern Washington and the remaining two-thirds in western Washington, with a slightly higher ratio of rate-class-40 employers in eastern counties.

When both geographic factors are considered together, the differences between rate class 40 and all employers were primarily in the rural east and urban west. In the rural west and urban east, the ratios of rate-class-40 employers to all employers were about the same. However, in the rural east, a larger percentage of employers were in rate class 40 and in the urban west, a smaller percentage were in rate class 40.

Location of employers in rate class 40 vs. all employers			
	Location	Rate-class-40 employers	All employers
High-level	Rural	37%	31%
	Urban	63%	69%
	East	37%	29%
	West	63%	71%
Detailed	Rural East	25%	19%
	Rural West	12%	12%
	Urban East	12%	10%
	Urban West	51%	59%

Figure 1

¹³ This industry includes foundation contractors, electricians, roofing companies, etc.

¹⁴ This industry includes companies that build highways, dams and other major infrastructure projects.

¹⁵ This industry includes companies that build commercial properties, not homes.

¹⁶ See Appendix C for numbers and percentages of other business characteristics.

In 2005, just over 53 percent of employers in rate class 40 had one employee (or less on an annual basis) compared to 42 percent of all employers. The industry sectors in rate class 40 that had the highest concentration of employers with one employee were private households and specialty trade contractors - the same industry sectors that had the highest representation overall in rate class 40 in 2005.

The business structure of employers in rate class 40 was also similar to that of all employers. Approximately 50 percent were corporations; 40 percent were sole proprietors; and 10 percent were partnerships, limited liability companies and other types of businesses.

Size of employers in rate class 40 vs. all employers		
Number of employees ¹⁷	Rate-class-40 employers	All employers
0-1	53.2%	42.1%
2-4	25.2%	25.0%
5-10	11.3%	16.0%
11-50	8.1%	13.3%
>50	2.2%	3.6%

Figure 2

Well-established businesses¹⁸ made up most of the employers in rate class 40: 84 percent compared to 74 percent of all qualified employers.

Movement of employers in rate class 40 in 2005

There were 5,338 employers that moved into rate class 40 in 2005. This group represented 40 percent of the employers in rate class 40 that year.

Of these employers, more than one-fourth were *non-qualified employers* in 2004. Upon becoming *qualified employers* in 2005, they were immediately assigned to rate class 40.

About 14 percent went from the lowest tax rate (rate class 1) in 2004 to the highest tax rate (rate class 40) in 2005.

Movement into rate class 40 in 2005	
Rate class in 2004	% of 5,338 employers that moved into rate class 40 in 2005
Non-qualified	28.1
1	14.1
2-10	4.4
11-20	6.0
21-30	9.3
31-35	15.8
36-39	22.3

Figure 3

The other 58 percent moved into rate class 40 from another rate class, with more movement into rate class 40 from the higher rate classes. Most employers did not move from the lowest rate classes into the highest rate class from one year to the next; they were already in the upper half of the rate classes before moving into rate class 40.

Most of the employers in rate class 40 in 2005 had not been there very long. In addition to the 40 percent that moved in that year, 22 percent had been there for only two years (since 2004), 15 percent for three years, 7 percent for four years, 3 percent for five years and 13 percent for six years or more.

¹⁷ Calculated as the average number of workers employed per month over a one-year period. The average can be less than one. For example, when a business employs only one worker for only 6 months, the monthly average over the entire year would be 0.5. Data source: ESD Labor Market & Economic Analysis database for the ES-202 report.

¹⁸ Well-established businesses: Employers that went into business prior to 4/1/2001.

Movement of employers in rate class 40 in 2000

To address the question of how long employers spend in rate class 40 before moving out of it, the study team first determined which qualified employers for the 2000 rate year would have been in rate class 40 based on their benefit ratios¹⁹. In 2000, there were 9,664 such employers. The study team used data available for those employers' tax rates from 1995 through 2005.

To determine how long employers were in rate class 40, the study team looked at the group of employers that moved in after 1995 and moved out by 2005. Those employers spent an average of three years in rate class 40, with more than half staying for one to four consecutive years before moving out. Less than half of one percent moved out after nine years.

The 1,774 employers (18.4 percent) that were in rate class 40 in 2000 and still there in 2005 includes about 675 employers that were in rate class 40 every year for at least 11 years (1995-2005), and possibly longer (before 1995 or after 2005). Employers in all agricultural, forestry, hunting, fishing and construction industries accounted for 82 percent of these "long-term rate-class-40" employers.

The study team was unable to determine the length of time that some employers spent in rate class 40 (labeled *indeterminate* in figure 4) because although they moved out by 2005, they were already in rate class 40 in 1995 and no data were available to determine how long they had been there before that year. Hence, the employers in this group must have been in rate class 40 for at least six years.

Slightly more than 35 percent of the employers in rate class 40 in 2000 moved out of it because they went out of business by 2005²⁰. It is important to note that the nation and state experienced a recession during this time²¹. The industry sectors with the largest representation of employers in this group were the same as in rate class 40 in 2005: private households (18 percent), specialty trade contractors (12 percent), and fruit and vegetable farming (9 percent).

Effect of the recession

The study team analyzed the effect of the recession on employers moving into and staying in rate class 40. According to the National Bureau of Economic Research, the recession lasted from March 2001 through November 2001. In Washington State, the end of the recession is much less clear since

Time spent in rate class 40 from 1995-2005	
Consecutive years in rate class 40 before moving out	% of 9,664 employers that were in rate class 40 in 2000
1	15.7
2	12.4
3	11.7
4	16.5
5	7.6
6	3.2
7	1.7
8	0.9
9	0.4
Still in rate class 40	18.4
Indeterminate	11.4

Figure 4

Note: Data above include the 35 percent of employers that went out of business prior to 2006. They are represented in the table by the number of years they were in rate class 40 before going out of business

¹⁹ Prior to 2005, a 20-rate-class system was used.

²⁰ Employers that reported a successor are not included in this calculation because they are still in business in some form.

²¹ See *Effect of the recession* below for information on the time period of the recession and its effect on rate-class-40 employers.

employment figures continued to decline well beyond November 2001. In fact, the seasonally adjusted unemployment rate²² in Washington remained above 7 percent through the end of 2003.

Experience tax rates are calculated each year based on the amount of benefit charges during the previous four fiscal years. If the recession affected employers moving to rate class 40, it is logical that a higher proportion of employers would be assigned to rate class 40 each year that included more recession-period charges in the calculation.

Tax rates for the year 2005 were based on the four-year period with the greatest number of recession-period charges²³. The percentage of employers in rate class 40 grew from 7.7 percent in 2001 to 8.4 percent in 2003, and reached 9 percent in 2005. This increase indicates that the recession caused a larger proportion of employers to be assigned to the highest tax rate class.

The study team anticipates that the recession will continue to affect the number of employers that stay in rate class 40 until 2007 or 2008 and will not be seen after 2008 because recession-period charges will no longer be included in the four-year period used to calculate tax rates.

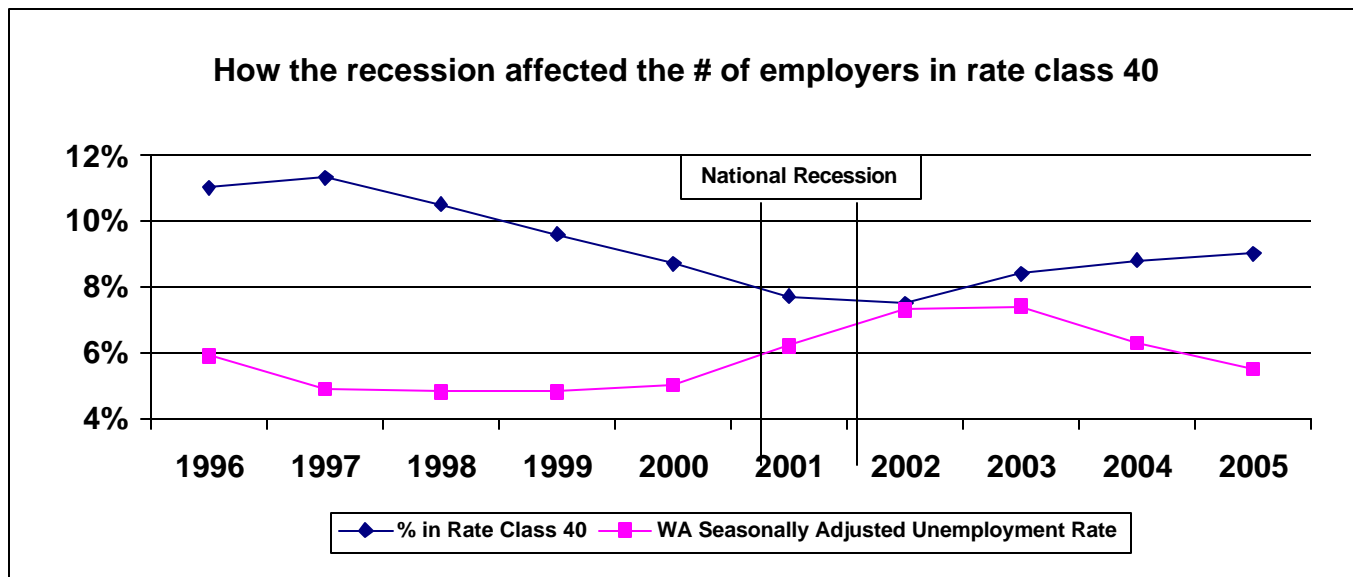


Figure 5

Characteristics of employers that stay in rate class 40 for many years

Of the 30,911 employers that were assigned to rate class 40 in at least one year between 2000 and 2005, 1,774 were assigned each and every year. The following industries account for 77 percent of the employers that were in rate class 40 for each of the past six years²⁴:

- **Construction** (38 percent): This includes employers in specialty trade construction (21 percent); heavy and civil engineering construction (9 percent); non-residential construction and residential building construction (4 percent each).

²² The unemployment rate represents total unemployment, not the insured unemployment rate.

²³ Tax rate year 2005 used benefit charges from July 2000 through June 2004, which includes both the national and state recession time-periods. The years 2002-2004 and 2006 used some, but not all, recession-period charges.

²⁴ See Appendix D for numbers and percentages by industry sector.

- **Agriculture, forestry and hunting** (33 percent): This includes employers in fruit and vegetable farming (14 percent) and other agriculture, forestry and hunting industries(19 percent).
- **Fishing** (6 percent).

Figure 6 shows the breakout of where the 1,774 employers that were in rate class 40 for the past six years were located. Their distribution is quite different than for all employers in 2005, for both rural versus urban and Eastern versus Western Washington. A substantially greater percentage of employers that have been in the highest rate class since 2000 were located in rural counties and in Eastern Washington.

Location of employers that stay in rate class 40 vs. all employers			
	Location	Employers in rate class 40 every year 2000 - 2005	All employers in 2005
High-level	Rural	59%	31%
	Urban	41%	69%
	East	60%	29%
	West	40%	71%
Detailed	Rural East	41%	19%
	Rural West	18%	12%
	Urban East	19%	10%
	Urban West	22%	59%

Figure 6

A substantially lower percentage of the employers that were in rate class 40 for the past six years had only one employee compared to all employers in 2005. This was offset by a greater percentage in every other employer-size range.

Size of employers that stay in rate class 40 vs. all employers		
Number of employees ²⁵	Employers in rate class 40 every year 2000 - 2005	All employers in 2005
0-1	29.0%	42.1%
2-4	31.3%	25.0%
5-10	18.5%	16.0%
11-50	16.5%	13.3%
>50	4.7%	3.6%

Figure 7

Slightly more than 58 percent of all employers that were in rate class 40 for the past six years were corporations ; 37 percent were sole proprietors. Corporations made up 50 percent of all employers in 2005, while sole proprietors accounted for about 40 percent.

Benefit ratios of employers in rate class 40 in 2005

The experience tax rate for employers in rate class 40 is set by law at 5.4 percent (0.054), but their benefit ratios are at least 5.75 percent (0.0575). To recoup all benefits charged to their accounts, each employer would need to pay an experience tax rate equal to its benefit ratio²⁶.

²⁵ Calculated as the average number of workers employed per month over a one-year period. The average can be less than one. For example, when a business employs only one worker for only 6 months, the monthly average over the entire year would be 0.5. Data Source: ESD 202 report database

²⁶ The benefit ratio is the ratio between an employer's benefit charges and taxable wages (benefit charges divided by taxable wages, both over a four-year period).

For 2005, employers in rate class 40 had benefit ratios ranging from 5.75 percent to greater than 100 percent, but all had an experience tax rate of 5.4 percent. This means that employers with a benefit ratio of 10.8 percent or higher paid experience taxes at a rate that covered only half or less of the benefits charged to their accounts. This was the case for 35 percent of the employers in rate class 40 in 2005.

Benefit ratios of employers in 2005			
Benefit ratio		# of employers in 2005	% of employers in rate class 40
At least	Less than		
0.0575	0.075	4084	30.5
0.075	0.10	3737	27.9
0.10	0.15	3429	25.6
0.15	0.25	1830	13.6
0.25		330	2.4

Figure 8

Three employers had a benefit ratio greater than 100 percent, which means they had more benefits charged to their accounts than they paid to their workers in taxable wages. Also, their experience taxes covered less than 5 percent of the benefits charged to their accounts - their tax rate (5.4 percent) compared to their benefit ratio (between 113 percent and 326 percent).

Unemployment benefits and taxes

Employers in rate class 40 paid \$172 million in taxes for rate year 2005 and had benefit charges totaling \$286 million in fiscal year 2004²⁷. The difference between these taxes and benefit charges is \$114 million of ineffective charges²⁸. No other rate classes or category of non-qualified employers had ineffective charges for that time period²⁹.

Benefits paid to employees of employers that were in rate class 40 actually totaled \$374 million in fiscal year 2004. The \$88 million difference between the amount of benefits paid versus those charged is caused by several elements: a portion of these payments were charged to employers in other rate classes³⁰; another portion were deemed overpayments that the employees have to pay back; others were not charged to any employer per state law (commonly known as *benefit charge relief*)³¹. Data were not available to provide a meaningful dollar breakout of each of these elements.

Scope

Section 24 of Engrossed Substitute Senate Bill 6885 directed Employment Security to conduct four studies on various elements of the unemployment-insurance system. This study covers the topic of employers in rate class 40. The other three study reports (repeat episodes of unemployment, employer turnover and corporate officers) are available online at www.studies.go2ui.com. Study reports are due December 1, 2006.

²⁷ July 2003 through June 2004.

²⁸ Ineffective charges: The amount of charges in a fiscal year that are not paid back in taxes the following calendar year by employers in that rate class. See *Background* section of this study report for information on how subsidization of rate class 40 occurs.

²⁹ The amount of ineffective charges shown in previously-distributed documents differs from the amounts in this study because previous calculations were based on estimated taxes as required by federal reporting requirements. The figures in this study are based on the actual amount of taxes paid, because that data were available at the time of the study.

³⁰ When someone worked for multiple employers during the year and a half prior to filing for UI benefits, each of those employers is charged a percentage of the benefit payments based on the percentage of wages that employer paid to that worker compared to all wages paid to that worker during that time.

³¹ RCW 50.29.021 specifies numerous situations in which employers are not *charged* for benefits paid to their workers.

For most aspects of this study, the study team considered employers that were in rate class 40 in 2005, because it is the only full year the 40-rate-class system was used to assign experience tax rates. To look at employers who moved out of rate class 40, the study team used the year 2000, which was far enough back in time to track employers who moved out of the highest rate class over time. Because a 20-rate-class system was used prior to 2005, the study team determined which of the 40 rate classes employers would have been in if the 40-class system had been in effect for years prior to 2005.

This study researched only qualified, non-reimbursable employers, because non-qualified and reimbursable employers are not assigned to a rate class³².

All employers in rate class 39 also have benefit ratios higher than 0.054 (5.4 percent) and a tax rate that is lower than their benefit ratios. This also is true for some employers in rate class 38. However, because the topic of this study is employers in rate class 40, other rate classes were not studied. Historically, only 0.6 percent of employers are in either rate class 38 or 39.

Conclusions

Approximately 9 percent of all employers were in rate class 40 in 2005. Employers in agriculture, fishing and construction had a substantially greater representation in rate class 40, compared to all employers. These industries also had a greater percentage of employers within the industry that were assigned to rate class 40 than in other industries. For example, more than 71 percent of all employers in the fishing industry are in rate class 40, but less than 3 percent of all employers in the retail grocery industry are in rate class 40³³.

Employers in rate class 40 had a larger percentage of employers located in rural counties and in Eastern Washington than did all employers.

The employers in this highest rate class were similar to all employers in business structure - predominantly either corporations or sole proprietors. However, there was a greater percentage of small employers in rate class 40 than for all employers – more than half had only one employee and more than three-fourths had four or fewer employees.

More employers in rate class 40 had been in business longer than five years when compared to all employers.

Most employers who moved into the highest rate class in 2005 from a lower rate class in 2004 did so from a rate class above 20; fewer jumped from rate classes 20 or lower. Approximately 13 percent of employers in rate class 40 in 2005 had been there since 2000.

³² Qualified employers: Businesses with employees over a specific time period that have submitted all reports, and paid all taxes, penalty, and interest charges as of September 30. RCW 50.29.010(6)

Non-qualified employers are assigned special tax rates. RCW 50.29.025(2)(c) & (d).

Reimbursable employers: Businesses that pay dollar for dollar on all unemployment benefits paid to former employees.

Eligible businesses include state, county and local government; public schools; some tribal entities; and non-profit organizations with 501(c)(3) status. RCW 50.44.010, .50.44.020, 50.44.030, 50.44.060 and 50.50.030.

³³ See Appendix B.

Employers with benefit ratios that would have put them in rate class 40 in 2000, but who subsequently moved out of it, spent an average of three years there before moving out. The recession of 2001 brought an increasingly greater percentage of employers into the top rate class than were there when the recession started.

Employers that stayed in rate class 40 for many years also were predominantly in agricultural, fishing and construction industries. A substantially greater percentage of employers that stayed in rate class 40 for the long term were located in rural counties and in Eastern Washington compared to all employers in 2005. There also was a larger percentage of corporations, but a much lower percentage of small employers.

Employers in rate class 40 have an experience tax rate that is lower than their benefit ratio; many have a substantially lower rate. In some years, they also realize a reduction in their social tax rate because of the cap on combined taxes (6.5 percent for most employers; less for certain industries). These two factors result in employers in other rate classes subsidizing the employers in rate class 40. For 2005, employers in the top rate class had \$114 million dollars in ineffective charges; the lower rate classes did not have any ineffective charges that year. To keep the trust fund stable, employers in other tax rate classes must make up this difference.

Appendices

Mandate for this study

2006 Legislative Session; ESSB 6885, Section 24:

The employment security department shall study the following and report its findings and recommendations, if any, to the unemployment insurance advisory committee and to the house of representatives commerce and labor committee and the senate labor, commerce, research, and development committee, or their successor committees, by December 1, 2006:

(2) Employers in rate class 40, including types of industries, sizes of employers, contributions paid, and benefit charges attributable to such employers;

Internet resources

Engrossed Substitute Senate Bill 6885 (ESSB 6885):

<http://www.leg.wa.gov/pub/billinfo/2005-06/Pdf/Bills/Senate%20Passed%20Legislature/6885-S.PL.pdf>

RCW 50.29.025 (Experience and social tax rates):

<http://apps.leg.wa.gov/RCW/default.aspx?cite=50.29.025>

RCW 50.29.041 (Solvency surcharge):

<http://apps.leg.wa.gov/RCW/default.aspx?cite=50.29.041>

Study team

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See following pages for Appendices A – D

Unemployment Tax Rate Classes and Calculations

Array Calculation Factor Rate³⁴
(Experience Tax Rate)

Benefit ratio		Rate class	Rate
At least	Less than		
	0.000001	1	0.00%
0.000001	0.001250	2	0.13%
0.001250	0.002500	3	0.25%
0.002500	0.003750	4	0.38%
0.003750	0.005000	5	0.50%
0.005000	0.006250	6	0.63%
0.006250	0.007500	7	0.75%
0.007500	0.008750	8	0.88%
0.008750	0.010000	9	1.00%
0.010000	0.011250	10	1.15%
0.011250	0.012500	11	1.30%
0.012500	0.013750	12	1.45%
0.013750	0.015000	13	1.60%
0.015000	0.016250	14	1.75%
0.016250	0.017500	15	1.90%
0.017500	0.018750	16	2.05%
0.018750	0.020000	17	2.20%
0.020000	0.021250	18	2.35%
0.021250	0.022500	19	2.50%
0.022500	0.023750	20	2.65%
0.023750	0.025000	21	2.80%
0.025000	0.026250	22	2.95%
0.026250	0.027500	23	3.10%
0.027500	0.028750	24	3.25%
0.028750	0.030000	25	3.40%
0.030000	0.031250	26	3.55%
0.031250	0.032500	27	3.70%
0.032500	0.033750	28	3.85%
0.033750	0.035000	29	4.00%
0.035000	0.036250	30	4.15%
0.036250	0.037500	31	4.30%
0.037500	0.040000	32	4.45%
0.040000	0.042500	33	4.60%
0.042500	0.045000	34	4.75%
0.045000	0.047500	35	4.90%
0.047500	0.050000	36	5.05%
0.050000	0.052500	37	5.20%
0.052500	0.055000	38	5.30%
0.055000	0.057500	39	5.35%
0.057500		40	5.40%

Graduated Social Cost Factor (Social Tax Rate)³⁵

The *graduated social cost factor* is calculated by multiplying the *flat social cost factor* by a certain percentage for each rate class.

- How the *flat social cost factor* is calculated:
 - Subtract all experience taxes for the prior fiscal year from all benefits during that same fiscal year.
 - Divide that difference in taxes and benefits by the amount of taxable wages during that same fiscal year.
 - The result is reduced depending on the amount in the unemployment trust fund.
 - The minimum for the *flat social cost factor* is 0.6 percent until 2007. Starting in 2007, the minimum is 0.45 percent for rate-class-1 employers and 0.5 percent for all other rate classes.
 - For certain industries, the graduated social cost factor is zero from July 1, 2005 through December 31, 2007.
- Percentage for each rate class and example social tax rates:

Rate class	Percent of flat social cost factor assigned to rate class	2005 social tax rate (flat social cost factor was 1.02%)	2007 social tax rate (flat social cost factor is 0.45% for rate class 1; otherwise 0.50%)
1	78%	0.80%	0.35%
2	82%	0.84%	0.41%
3	86%	0.88%	0.43%
4	90%	0.92%	0.45%
5	94%	0.96%	0.47%
6	98%	1.00%	0.49%
7	102%	1.04%	0.51%
8	106%	1.08%	0.53%
9	110%	1.12%	0.55%
10	114%	1.16%	0.57%
11	118%	1.20%	0.59%
12 - 40	120%	1.22%	0.60%

Contribution Rate (Combined Tax Rate)³⁶

- The total of the experience and social tax rates for any rate class can be no more than 6.5 percent for qualified employers in most industries. If it is, the social tax rate is reduced for that rate class. For example, in 2005, rate class 40 was only assessed a 1.1 percent social tax rate instead of 1.22 percent, because the experience tax rate is 5.4 percent and the total cannot exceed 6.5 percent.
- Qualified employers in some industries have a maximum combined rate of 6 percent through 2007; then 5.7 percent.

Any solvency surcharge is included in the contribution rate, but is not used when calculating the maximum. The solvency surcharge cannot be more than 0.2 percent. The current trust fund balance does not trigger a solvency surcharge.

³⁴ RCW 50.29.025(2)(a)

³⁵ RCW 50.29.025(2)(b)

³⁶ RCW 50.29.025(2) and 50.29.025(2)(b)(ii)(A)

Number and Percent of Employers by Industry – Rate Class 40 and All Employers in 2005³⁷

INDUSTRY	Rate Class 40		All Rate Classes		Percent of all Employers in each Industry that are in Rate Class 40
	Number	Percent	Number	Percent	
ALL INDUSTRIES	13,410	100.0%	148,581	100.0%	9.0%
Agriculture: Fruits, Vegetables	825	6.2%	2,996	2.0%	27.5%
Other Agriculture, Forestry, Hunting	734	5.5%	3,872	2.6%	19.0%
Fishing	271	2.0%	379	0.3%	71.5%
Mining	35	0.3%	143	0.1%	24.5%
Utilities	9	0.1%	309	0.2%	2.9%
Construction: Residential Building	693	5.2%	4,153	2.8%	16.7%
Construction: Nonresidential Building	359	2.7%	934	0.6%	38.4%
Construction: Heavy, Highway, Civil Engineering	452	3.4%	1,127	0.8%	40.1%
Construction: Specialty Trade Contractors	2,261	16.9%	9,667	6.5%	23.4%
Manufacturing: Food, Beverage, Clothing	100	0.7%	1,101	0.7%	9.1%
Manufacturing: Wood, Chemical, Nonmetallic Mineral	152	1.1%	1,726	1.2%	8.8%
Manufacturing: Metal, Machine, Transportation	338	2.5%	3,190	2.1%	10.6%
Manufacturing: Aerospace	22	0.2%	149	0.1%	14.8%
Wholesale Trade - Other than Grocery	713	5.3%	9,115	6.1%	7.8%
Wholesale Trade - Grocery	40	0.3%	661	0.4%	6.1%
Retail Trade: Specialty - Other than Grocery	344	2.6%	7,445	5.0%	4.6%
Retail Trade: Grocery	29	0.2%	1,002	0.7%	2.9%
Retail Trade: General, Miscellaneous	134	1.0%	3,745	2.5%	3.6%
Transportation	383	2.9%	2,611	1.8%	14.7%
Warehousing	17	0.1%	313	0.2%	5.4%
Information	158	1.2%	1,744	1.2%	9.1%
Finance, Insurance	153	1.1%	4,459	3.0%	3.4%
Real Estate, Rental, Leasing	252	1.9%	5,233	3.5%	4.8%
Services: Professional, Scientific, Technical	762	5.7%	11,868	8.0%	6.4%
Services: Management of Companies and Enterprises	12	0.1%	158	0.1%	7.6%
Services: Administrative, Support	557	4.2%	5,799	3.9%	9.6%
Services: Waste Management	39	0.3%	302	0.2%	12.9%
Services: Education	52	0.4%	1,369	0.9%	3.8%
Services: Health Care, Social Assistance	229	1.7%	10,704	7.2%	2.1%
Services: Arts, Entertainment, Recreation	109	0.8%	1,866	1.3%	5.8%
Services: Accommodation	84	0.6%	1,182	0.8%	7.1%
Services: Food	145	1.1%	7,873	5.3%	1.8%
Services: Repair, Maintenance	251	1.9%	3,691	2.5%	6.8%
Services: Personal, Laundry	52	0.4%	2,372	1.6%	2.2%
Services: Religious, Grantmaking, Civic, Professional	138	1.0%	2,364	1.6%	5.8%
Services: Private Household	2,500	18.6%	32,732	22.0%	7.6%
Public Administration	6	0.0%	227	0.2%	2.6%

³⁷ This table includes qualified employers only. Non-qualified employers are not assigned to a rate class. See page 1 for details. Data Source: ESD Data Warehouse: Tax Rate and Employer Tables

Other Business Characteristics – Rate Class 40 and All Employers in 2005³⁸

	Rate Class 40		All Rate Classes	
	Number	Percent	Number	Percent
ALL EMPLOYERS	13,410	100.0%	148,581	100.0%

LOCATION

Rural Counties	4,988	37.2%	46,421	31.2%
Urban Counties	8,422	62.8%	102,160	68.8%
Eastern Washington	4,942	36.9%	42,741	28.8%
Western Washington	8,468	63.1%	105,840	71.2%
Rural Eastern Counties	3,296	24.6%	28,283	19.0%
Rural Western Counties	1,692	12.6%	18,138	12.2%
Urban Eastern Counties	1,646	12.3%	14,458	9.7%
Urban Western Counties	6,776	50.5%	87,702	59.0%

SIZE

0-1 employee	7,138	53.2%	62,586	42.1%
2-4 employees	3,373	25.2%	37,128	25.0%
5-10 employees	1,510	11.3%	23,718	16.0%
11-50 employees	1,090	8.1%	19,797	13.3%
>50 employees	299	2.2%	5,352	3.6%

BUSINESS STRUCTURE

Corporation	6,843	51.0%	74,010	49.8%
Limited Liability Company	400	3.0%	7,718	5.2%
Limited Liability Partnership	4	0.0%	118	0.1%
Partnership	252	1.9%	3,214	2.2%
Sole Proprietor	5,582	41.6%	59,096	39.8%
Other	329	2.5%	4,425	3.0%

LENGTH OF TIME IN BUSINESS

Well Established (before 4/1/01)	11,291	84.2%	110,241	74.2%
Newer (after 4/1/01)	2,119	15.8%	38,340	25.8%

³⁸ This table includes qualified employers only. Non-qualified employers are not assigned to a rate class. See page 1 for details. Data Source: ESD Data Warehouse: Tax Rate and Employer Tables

Employers in Rate Class 40 every year 2000 – 2005
Number and Percent by Industry³⁹

INDUSTRY	Rate Class 40 every year 2000 - 2005	
	Number	Percent
ALL INDUSTRIES	1,774	100.0%
Agriculture: Fruits, Vegetables	249	14.0%
Other Agriculture, Forestry, Hunting	336	18.9%
Fishing	113	6.4%
Mining	10	0.6%
Utilities	1	0.1%
Construction: Residential Building	69	3.9%
Construction: Nonresidential Building	68	3.8%
Construction: Heavy, Highway, Civil Engineering	160	9.0%
Construction: Specialty Trade Contractors	373	21.0%
Manufacturing: Food, Beverage, Clothing	26	1.5%
Manufacturing: Wood, Chemical, Nonmetallic Mineral	19	1.1%
Manufacturing: Metal, Machine, Transportation	30	1.7%
Manufacturing: Aerospace	0	0.0%
Wholesale Trade - Other than Grocery	19	1.1%
Wholesale Trade - Grocery	4	0.2%
Retail Trade: Specialty - Other than Grocery	23	1.3%
Retail Trade: Grocery	1	0.1%
Retail Trade: General, Miscellaneous	6	0.3%
Transportation	77	4.3%
Warehousing	3	0.2%
Information	3	0.2%
Finance, Insurance	1	0.1%
Real Estate, Rental, Leasing	10	0.6%
Services: Professional, Scientific, Technical	26	1.5%
Services: Management of Companies and Enterprises	2	0.1%
Services: Administrative, Support	55	3.1%
Services: Waste Management	4	0.2%
Services: Education	1	0.1%
Services: Health Care, Social Assistance	5	0.3%
Services: Arts, Entertainment, Recreation	16	0.9%
Services: Accommodation	18	1.0%
Services: Food	6	0.3%
Services: Repair, Maintenance	18	1.0%
Services: Personal, Laundry	1	0.1%
Services: Religious, Grantmaking, Civic, Professional	2	0.1%
Services: Private Household	19	1.1%
Public Administration	0	0.0%

³⁹ This table includes qualified employers only. Non-qualified employers are not assigned to a rate class. See page 1 for details. Data Source: ESD Data Warehouse: Tax Rate and Employer Tables